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March 31, 2003

Chief of Records
Office of Foreign Assets Control
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Attention: Request for Comments

Re: Economic Sanctions
Enforcement Guidelines

Dear Sirs:

The New York Clearing House Association L.L.C.[1] ("The Clearing House") is pleased to comment on the proposed Economic Sanctions Enforcement Guidelines ("Guidelines").[2] The Guidelines

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1 The members of The Clearing House are Bank of America, National Association; The Bank of New York; Bank One, National Association; Citibank, N.A.; Deutsche Bank Trust Company Americas; Fleet National Bank; HSBC Bank USA; JPMorgan Chase Bank; LaSalle Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association. American Express Bank Ltd. and the U.S. offices of UBS AG, members of our affiliate, The Clearing House Interbank Payments Company L.L.C., support the views expressed in this comment letter.

2 68 Fed. Reg. 4422 (Jan. 29, 2003).

are an updated version of internal guidelines that have been used to guide the enforcement of economic sanctions programs that OFAC administers.

INTRODUCTION

The Clearing House has long supported making OFAC's procedures more transparent. The Judicial Review Commission on Foreign Assets Control also recommended that OFAC incorporate the standards and procedures that it follows in enforcing its programs in regulations, thereby making them public and giving them the force of law.[3] The Clearing House strongly supports OFAC's publication of the Guidelines and making them a part of its public regulations.

Although we support publication of the Guidelines and agree that this is a good first step in making OFAC's procedures more transparent, we also believe that the proposed Guidelines as published do not provide sufficient protection for banks and other business entities that may be subject to OFAC enforcement actions.

The Guidelines describe an escalating series of actions based upon OFAC's perception of the seriousness of the

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[3] Judicial Review Commission on Foreign Assets Control, Final Report to Congress at 141 (Jan. 2001) ("Final Report").

event. Where OFAC has not found a violation but has found a lack of due diligence that could lead to future violations, OFAC will normally issue a "cautionary letter." Where OFAC has found an apparent violation, but the violation is only technical or other mitigating factors are present, OFAC will issue a "warning letter." In other cases, OFAC will initiate a civil penalty proceeding with a prepenalty notice that sets out the apparent violation and a "proposed penalty." The respondent is given a limited period of time to answer the prepenalty notice, after which, unless the respondent has agreed to an informal settlement, OFAC will issue a penalty notice setting forth a final penalty that takes account of any aggravating and mitigating factors that may be present. The issuance of a penalty notice is OFAC's final action and obligates the respondent to pay the penalty, unless the respondent can persuade a court to overturn the penalty.

COMMENTS

Cautionary Letters

Our major concerns with the Guidelines begin with the purpose and practical application of "cautionary letters." The Guidelines provide that OFAC will issue a cautionary letter

> [w]here an OFAC audit or civil investigation results in insufficient evidence to conclude that a violation appears to have occurred, but which may indicate activity

that could lead to a violation in other circumstances or cause problems for future transactions.[4]

If OFAC has determined that there is insufficient evidence to conclude that a violation has occurred, then what purpose does a cautionary letter serve? Will the cautionary letter explain what "other circumstances" could lead to a violation? Upon receiving a cautionary letter, does a financial institution have any responsibility to take affirmative action with regard to the suspect account? Perhaps more importantly, should the financial institution take affirmative measures (e.g. closing an account, terminating a relationship) based upon information provided in a cautionary letter, will OFAC provide safe harbor for such measures?

Financial institutions increasingly face uncertainties over whether a particular transaction is prohibited by an OFAC sanction or regulation. Nevertheless, the proposed Guidelines do not provide for a formal inquiry and response format. Thus, as the reporting deadline approaches, and a financial institution awaits OFAC's interpretation of a particular sanction or regulation, the financial institution must weigh the risk of prematurely blocking a suspect transaction against being

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[4] 68 Fed. Reg. at 4426.

found in violation for not blocking and reporting in a timely manner.

As defined by the Guidelines, a "voluntary disclosure" is a notification to OFAC regarding **possible** sanctions violations. However, voluntary disclosure is listed only as a mitigating factor in section B, *Evaluation of Mitigating and Aggravating Factors*,[5] which occurs **after** OFAC has determined that a penalty will be assessed. Perhaps a voluntary disclosure seeking guidance, followed by a cautionary letter providing interpretation within a reasonable amount of time, may provide a more formulaic and ultimately more systematic reporting procedure.

Warning Letters

The Clearing House is also concerned with the narrow scope OFAC has given the warning letter process. The Guidelines state that "OFAC issues warning letters in lieu of civil penalties in cases that appear to involve violations based on technicalities, where good faith efforts to comply with the law

[5] Id. at 4427.

and no aggravating factors are present."[6] But the list of technical violations is really quite narrow: Where the name in the payment order is spelled differently from the name as it appears in the OFAC list, or where there are other significant variations in the name or address so that the payment order clears the bank's electronic filter; where a clerk accidentally routes a funds transfer through a blocked bank; where a clerk accidentally hits a "release" instead of a "block" key; or where the bank has not had time to add a new name to its filter.

We believe that this list should be expanded to make OFAC's procedures more fair to banks and other institutions that are making comprehensive good faith efforts to comply with OFAC's rules, and that this expansion would come without any detriment to the government's policy objectives. In the first place, warning letters rather than civil penalties should be used whenever an institution with an OFAC compliance program that meets reasonable standards voluntarily discloses its violation, so long as the institution takes reasonable steps to ensure that a similar violation does not subsequently occur.

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[6] Id. at 4426.

Second, no penalty should be assessed where the violation involves a person or entity that does not appear on any OFAC list. OFAC persists in assessing penalties when it believes that persons subject to its jurisdiction "should have known" that a particular person or entity is blocked even though that person or entity may not be included in any of its lists. But electronic filters that screen for blocked parties must be constructed from one or more authoritative sources; the people who build the databases that populate the filters cannot be expected to know all of the parties that might be blocked under OFAC's should-have-known standard. In any case, if a reasonable person should know that a person or entity is closely affiliated with a blocked country or group, OFAC should be expected to include that name on one of its lists.

We also believe that transactions where a clerk accidentally hits a "release" key instead of a "block" or "reject" key should warrant, at most, a cautionary letter rather than a warning letter. The same is true for transactions where "a bank employee accidentally hits a code for an SDN bank."

Prepenalty Notices

The Clearing House members believe that OFAC should take note of mitigating factors before issuing a prepenalty

notice. Under the current procedure, the proposed penalty is always the maximum amount OFAC could impose under the relevant regulation, even if it is clear that mitigating factors (such as voluntary disclosure) are present. We believe that the maximum penalty should be reserved for cases in which aggravating factors, such as willfulness, are present. OFAC's practice puts banks and similar parties at an unfair disadvantage when negotiating with OFAC because it does not reflect the penalty that will actually be imposed. We therefore recommend that prepenalty notices report a proposed penalty that reflects all of the mitigating factors that OFAC is aware of at the time that it issues the prepenalty notice.

Aggravating and Mitigating Factors. The Clearing House also recommends modifications to OFAC's aggravating and mitigating factors. We agree that voluntary disclosure is an important mitigating factor, but OFAC has defined "voluntary disclosure" too narrowly and in a way that inhibits cooperation and the exchange of information among banks. OFAC does not regard notification as voluntary if OFAC has already found out about the transaction from another source, for example, because another bank has blocked the transaction and filed a report with OFAC. Nevertheless, a bank's voluntary disclosure may provide OFAC with information that is far superior to information that

OFAC received from another source. Suppose a bank inadvertently misses a sanctioned funds transfer and sends it on to the next bank, which properly rejects the payment order and sends notice of rejection to the sending bank. In that case, the sending bank will have to race to disclose the violation to OFAC before OFAC gets a report from the receiving bank, which rejected the transfer.

The Clearing House also does not believe that familiarity with economic sanctions programs should be an aggravating factor. The practical effect of listing familiarity with OFAC's program as an aggravating factor is that any institution that takes the trouble to learn about sanctions programs is automatically penalized for this knowledge. Listing knowledge as an aggravating factor could discourage the establishment of effective compliance programs. We believe that OFAC's legitimate concerns are adequately covered by other aggravating factors already listed, such as willfulness, disregard of notice from the government, and lack of a compliance program.

Whether or not an offense is a second offense also should not be an aggravating factor. Banks began screening their funds transfers years ago. But no screening system can be perfect, and there will always be payment orders that slip

through. We are at a point where each payment order that slips through, even if inadvertently or for the most technical of reasons, will always be a "second or subsequent offense," automatically creating an aggravating factor. Unless the violation is willful, the mere fact that this kind of thing has happened before should not be an aggravating factor.

The Clearing House banks also believe that the mitigation percentages have been unfairly reduced in the case of banks. In the case of funds-transfer violations by banks or other financial institutions, penalties are not mitigated by more than 50%, regardless of the presence of mitigating factors. For other types of entities and other types of transactions, mitigation may be as high as 75%. We see no reason for this disparity and strongly recommend that funds-transfer violations also be eligible for 75% mitigation.

Time Periods. We note that there is no discussion of time periods in the proposed Guidelines other than a reference to a party's request to OFAC to withhold the issuance of a prepenalty notice for the purpose of reaching a settlement. In practice, however, prepenalty notices provide that they must be responded to within 30 days, but there is no duty on OFAC to make its decision within a specified period, and it is not unheard of for OFAC to take up to three years to reach a

decision. This burdens the banks because so much time has passed that memories need to be refreshed and documents researched; in many cases, the people who have worked on the transaction have moved on to other jobs. We believe that OFAC should be required to make a decision with respect to a penalty within 180 days of the date on which it received the response to a prepenalty notice.

Standard of Evidence. Because alleged violations based on funds transfers are often based on a mere reference to a prohibited country or party in an information field of a payment order, banks find themselves compelled to respond to investigations with little or no understanding of the evidence or legal theory OFAC is relying on to conclude that a violation occurred. Preprenalty notices rarely do more that quote the regulations themselves and identify the transaction. OFAC should provide a summary of the evidence it is relying on to allow banks to effectively respond to prepenalty notices. Absent that evidence, the process for response is a mere formality with a foregone conclusion that a penalty will result.

Safe Harbor

Finally, The Clearing House strongly recommends that OFAC adopt the Judicial Review Commission's recommendation that

it "promulgate regulations specifying procedures that business entities may implement in order to come within a 'safe harbor' from civil liability."[7] In the Commission's words, "the proposed regulations should make it clear that if a business entity implements the actions specified in OFAC regulations to achieve compliance, the business entity will not be subject to civil liability."[8]

Similarly, if a financial institution implements the actions OFAC has specified, either orally or in writing, the financial institution would receive a safe harbor from civil liability in cases where a particular transaction or matter is not explicitly prohibited by an OFAC sanction or regulation.

In the banking industry, the greatest need is for a safe harbor in the funds-transfer area. The outlines of a safe harbor should be clear: If a bank adopts a commercially reasonable procedure for screening funds transfers and applies that procedure in a diligent manner, the bank will not be held liable for any transaction that the filter does not catch.

Each year, the banking industry expends millions in terms of dollars and burden hours complying with OFAC

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[7] Final Report at 141.

[8] Id.

regulations. Banks have invested heavily in screening technology. But this technology is not, and cannot ever be, infallible. Some payments will always get through. The fact that they will, however, cannot be anything other than inadvertent. We therefore strongly recommend that OFAC incorporate the safe harbor in the Guidelines.

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We hope these comments are helpful. If you want to discuss the letter, please call Joseph R. Alexander, Senior Counsel, at (212) 612-9334.

Very truly yours,

JPN:mlr

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